Office Supreme Court, U.S.
FILED
JUL 25 1983
ALEXANDER L. STEVAS,
CLERK

NO. 82-1760

IN THE
SUPREME COURT OF THE UNITED STATES

October Term, 1982

HEALTH CARE PLAN OF NEW JERSEY, INC.,
a federally qualified health
maintenance organization,

Petitioner,

vs.

MARGARET M. HECKLER, Secretary
United States Department of Health & Human Services;
J. RICHARD GOLDSTEIN, Commissioner,
New Jersey Department of Health;
New Jersey Hospital Rate Setting Commission,

Respondents,

PETITIONER'S REPLY MEMORANDUM

Robert F. Blomquist
DAVIS & REBERKENNY, P.A.
499 Cooper Landing Road
Cherry Hill, N.J. 08002
(609) 667-6000

Counsel for Petitioner

July 18, 1983

TABLE OF AUTHORITIES

Cases:	Page
Arizona v. Maricopa County Medical Soc., 102 S. Ct. 2466, 2470, n. 7 (1982)	14
Boy's Market, Inc. v. Retail Clerk's Union Local 770, 398 U.S. 235, 250 (1970)	7
Fidelity Federal Savings and Loan Association v. de la Cuesta, 102 S. Ct. 3014, 3022 (1982)	10
Southern Pacific Terminal Co. v. Interstate Commerce Comm'n, 219 U.S. 498. 514-15 (1911)	10

Statutes and Regulations:	
Federal Administrative Procedure Act, 5 U.S.C. §551 et seq.: 5 U.S.C. §701 et seq.	10
Health Maintenance Organization Act of 1973, 42 U.S.C. (& Supp. V) §300e et seq.:	
42 U.S.C. §300e	4, 6. 8, 16
42 U.S.C. §300e-10	12, 14
42 U.S.C. §300e-11	9

Statutes and Regulations: Page

National Health Planning and Resources Development Act of 1974 42 U.S.C. (& Supp. V) §§300k-300n: 42 U.S.C. (& Supp. V) §§300k-300n 3, 4, 6, 8 16,18

42 U.S.C. (& Supp. V) §300n-1(c)(8) 18

Social Security Act Amendments of 1983, Pub. L. No. 98-21, §601(c), 97 Stat. 150 (to be codified at 42 U.S.C. §1395) 1-6, 8 11,16

42 C.F.R. §110.904(c)(2) 10

Corrective Action Plan (CAP, U.S. Secretary of Health & Human Services, June 30, 1980) 9

Miscellaneous:

Conference Report (H.R.Rep. 47) 129 CONG. REC. H. 1777, S. 4084 (Daily Ed. March 24, 1983) (Cited at Pet. 12-13) 2

Health, United States 1980 (U.S. Dept. of Health and Human Services) 66-67 14

1982-1987 New Jersey State Health Plan (approved December 17, 1982) 16-18

PETITIONER'S REPLY MEMORANDUM

The Secretary of Health and Human Services ("Secretary"), the New Jersey Commissioner of Health and New Jersey Hospital Rate Setting Commission ("State Respondents") oppose the petition for a writ of certiorari in No. 82-1760. The respondents' reasons in opposition are unconvincing and distort the pertinent law and facts.

1. The Secretary, in her opposing brief, rewrites the substance of the Social Security Act Amendments of 1983, Pub. L. No. 98-21, §601(c), 97 Stat. 150 (to be codified at 42 U.S.C. §1395) ("Social Security Act Amendments of 1983"). This is evident from the following comparison:

Congressional Conference Report
Pet. 12-13

"Under present law, the Secretary has authority to establish Medicare demonstration projects. There are currently four statewide Medicare demonstrations (MD, NJ, NY and MA) and one area-wide (Rochester, NY demonstration).

* * *

[Section 601(c)] includes the [existing requirements] for approval of a State [hospital rate] system and adds a [further] requirement: if the Secretary determines that the State system will not preclude any HMO... from negotiating directly with hospitals with respect to payment for inpatient hospital services.

* * *

[F]or those states [such as Maryland and New Jersey] which currently have a Medicare waiver the Secretary would be required to continue the State program, if and for so long as, the conditions described above are met." (Emphasis provided).

The Secretary's Revision
U.S. Br. in Opp. 3-4

"The...issue raised by petitioner--whether New Jersey's hospital rate

> regulations, as applied to petitioner, are preempted by the HMO and the NHPRD Acts--lacks substantial prospective importance because recent passage of the Social Security Amendments of 1983...is likely to result in amendment of the New Jersey regulations to allow HMOs to negotiate rates directly with hospitals. Accordingly, further review of this issue is unwarranted.
>
> * * *
>
> For states such as New Jersey that already have and wish to maintain a federal waiver for DRG programs, Congress enacted legislation permitting continuation of the waiver only if the state exempts HMOs from the state DRG program. *** Because of the substantial financial incentive afforded by Medicare reimbursement, it is reasonable to expect that New Jersey will amend its DRG system and exempt HMOs. See, N.J. Br. in Opp. 4-5 n*." (Emphasis provided: citations omitted).

This transparent revision--bootstrapped by the State Respondents' vague, self-serving, and unproven assertion that "it may reasonably be expected that [New Jersey]

will undertake all action necessary to maintain continuation of Medicare participation," N.J. Br. in Opp. 4-5 n*--reflects the Secretary's consistent reluctance to accept the congressional premise delineated in the Health Maintenance Organization Act of 1973, 42 U.S. §300e et seq. ("HMO Act"), and the National Health Planning Resources and Development Act, 42 U.S.C. §§300k-300n ("NHPRDA") as amplified by the Social Security Act Amendments of 1983: state hospital rate laws which prevent HMOs from negotiating inpatient services rates with hospitals are "restrictive" under 42 U.S.C. §300e-10, and are, therefore, federally preempted.

Section 601(c) of the Social Security Act Amendments of 1983 clearly contemplates a situation where a state having a DRG program and existing Secretarial Medicare waiver may reasonably choose not to exempt

an HMO from the ambit of the state law for mere state policy reasons. If it were to be assumed that a "substantial financial incentive" automatically existed for any state having an all-payor DRG program, given past Secretarial Medicare waiver, to uniformly exempt HMOs, the state-choice mechanism contained in Section 601(c) would be superfluous. Accordingly, the Secretary's argument presents a logical non sequitur and is unsupported by any objective evidence of what New Jersey is currently doing--if anything--to exempt HMOs from the existing DRG program. Indeed, all objective indications at this writing are that the State Respondents are simply doing nothing--they are taking a "wait and see" posture.

The attempt by the state and federal respondents by unsubstantiated economic "guesstimate" to shift the congressional

intent away from prohibiting HMO-restrictive state laws and practices and over to state "incentives" which might conceivably cure existing restrictive state laws and practices, bares the flaw in respondents' opposition to the instant preemption claim. If the HMO Act, NHPRDA, and Social Security Act Amendments of 1983 could be written so as to merely prohibit what the Secretary and State Respondents now say the statutes prohibit--state DRG programs that fail to exempt HMOs when the state has no possible financial incentive to consider exempting the HMOs in the future--then perhaps the Secretary's point that the instant petition lacks substantial prospective importance would have merit.

But the Congress in enacting the HMO Act, NHPRDA, and the Social Security Act Amendments of 1983 rejected the respondents' argument that what a state might

decide to do in the future--based on its own subjective calculation of its own financial interests as it perceived them at any given moment--was the statutory purpose. Without mentioning "state financial interests", the Congress in "the total corpus of pertinent [statutory] law and the policies that inspired [those laws]"* marked out unequivocal federal policy toward HMOs: state laws and practices which interfere with federally qualified HMO operating incentives to directly control and manage their inpatient hospital costs are preempted. Thus, petitioner having been deprived of those rights, and facing the prospect of continued deprivation of those rights for an indeterminate future by New Jersey's DRG program,

---

* Boy's Market, Inc. v. Retail Clerk's Union Local 770, 398 U.S. 235, 250 (1970).

necessarily is entitled to be judicially relieved from New Jersey's long-standing "restrictive state laws and practices" inimical to its growth and development as a federally qualified HMO. Merely noting that New Jersey might--at any time in the future--exempt petitioner and other HMOs from the DRG scheme does not erase the past deprivation of petitioner's rights nor eliminate the state obligation to comply forthwith with federal law: not tomorrow or next month; not next year when the state gets around to it, but right now.

2. Other than the Secretary's non sequitur regarding the meaning of section 601(c) of the Social Security Act Amendments of 1983 read in pari materia with the HMO Act and NHPRDA, the importance and substantiality of the questions presented have not

been denied by the Secretary. The only additional claim by the Federal Respondent is that the issue of petitioner's compliance with the Secretarial Corrective Action Plan ("CAP") is now moot because in January 1982 the Secretary issued the requested declaration. See, U.S. Br. in Opp. 3. But review here cannot be moot where the Secretary's actions in acquiescing to a state law in the face of a clearly contrary federal CAP, which required the petitioner to negotiate per diem rates with hospitals, was never altered. Indeed, the Secretary's prolonged acquiescence as found by the lower court opinion "itself compounded the financial difficulties faced by [petitioner]". Pet. App. 19-21. In and of itself, the Secretary's arbitrary and capricious actions raise significant issues regarding the future integrity of Secretarial CAP determinations under 42 U.S.C. §300e-11 and

42 C.F.R. 110.904(c)(2) coupled with 5 U.S.C. §701 et seq., and the preemptive effect of those CAP regulations on conflicting state laws. Fidelity Federal Savings and Loan Association v. de la Cuesta, 102 S. Ct. 3014, 3022 (1982). Since the issue of the priority of Secretarial CAP determinations --which by their nature are transitory-- versus contrary state laws is "capable of repetition, yet evading review", in the sense that other federally qualified HMOs may confront the issue, the claim is not moot. Southern Pacific Terminal Co. v. Interstate Commerce Comm'n, 219 U.S. 498, 514-15 (1911) (short-term ICC orders would otherwise avoid review altogether because the orders, by their terms, would expire before the Supreme Court could ordinarily be expected to hear the case).

3a. The State Respondents seek to artificially narrow the scope and importance of the case at bar. It is argued

that the case "arose under relatively novel circumstances, particularly since New Jersey's system of hospital rate-setting was itself an innovative program in the field"; moreover, the State Respondents further argue that the undisputed legal issues of first impression presented herein are "of such uncommonly limited import" as to warrant denial of the Petition. N.J. Br. in Opp. 2. But the State Respondents severely undercut their own hyperbolic argument by acknowledging the fact that "use of prospectively determined rates classified by Diagnosis Related Groups has now been selected for Medicare payments for inpatient hospital services on a national basis effective October 1, 1983 as provided by the very recent Social Security Act Amendments of 1983...". (Emphasis provided: citations omitted). N.J. Br. in Opp. 4*.

Thus, the New Jersey experience with DRGs, and New Jersey's concomitant refusal

to exempt HMOs from that system portends widespread national impact since DRGs have obviously become the most popular form of state hospital cost containment regulation, and Congress has left the task of hospital cost containment to the states. The popularity of the DRG method is obviously based on its perceived potency in curbing hospital costs. As more and more states seek to quell their skyrocketing hospital costs with the strong medicine of DRGs, the issue of DRG impact on fundamental HMO operating incentives will recur in those states which choose, like New Jersey, to include all hospital payors in the regulatory scheme without exempting HMOs.

If the Court denies review of this important case of first impression, the meaning of the preemption provisions of 42 U.S.C. §300e-10 will be seriously muddled and misunderstood by the states;

the Court should dispel the dangerous circular logic of the State Respondents and lower courts' decisions herein that because the preemption provisions of the HMO Act were designed to set HMOs on "an equal footing with other providers of health care", exempting HMOs from state DRG laws would constitute "a special and distinct advantage over other providers and insurers in the medical marketplace". N.J. Br. in Opp. 7. Since it is uncontroverted by the State Respondents that the New Jersey DRG system visits special and unusual hardships on the fundamental operating incentives of HMOs "to discharge hospital patients as promptly as medically sound", N.J. Br. in Opp. 7, and to control the HMOs' inpatient hospital costs, Pet. 14-15; 34-35, the only purported "justification" for New Jersey's legal position that this impact does not constitute

"restrictive state laws and practices" under 42 U.S.C. §300e-10 is that HMOs are still left with "other" methods to minimize operating costs. N.J. Br. in Opp. 8. But such analysis is disingenuous and contrary to the full purposes and objectives of Congress in endorsing the HMO concept of prepaid health care services. See generally, Arizona v. Maricopa County Medical Soc., 102 S.Ct. 2466, 2470, n. 7 (1982). Indeed, New Jersey's DRG law eviscerates the most important HMO financial incentive envisioned by Congress: the incentive to control inpatient hospital costs of HMO enrollees which are the most costly of HMO operating expenses! (Pl. Ex. 2, p. 1; R. Vol. 1, 70 and 113-114; Vol. 2, 48-49). See also, Health United States 1980 (U.S. Dept. of Health and Human Services) 66-67.

3b. It is truly amazing that the State Respondents have the audacity to attempt at

this late hour to recharacterize their damning admissions (Pet. 13 to 15; 34 to 35) as "merely sympathetic reflections of the opinions related to the Department of Health by health maintenance organizations themselves". N.J. Br. in Opp. 12-13. To paraphrase Shakespeare, a rose by any other name would smell the same. Likewise, it defies reasoned discourse for the State Respondents to contend that the DRG rate law which admittedly strikes at the very heart of HMO fundamental operating incentives is even remotely analogous to water or electrical rates paid by an HMO. N.J. Br. in Opp. 13. The latter, of course, are incidental and unimportant to HMO operating incentives as envisioned by Congress, while the former are restrictive to the vital HMO financial incentives of controlling subscriber hospital costs.

3c. The State Respondents compound their incredible argument in opposition

by asserting the irrelevance of the NHPRDA to the instant case and by contesting the logic of reading portions of that Act in pari materia with the HMO Act and the Social Security Act Amendments of 1983. N.J. Br. in Opp. 13-14. Yet, in the body of New Jersey's own 1982-1987 New Jersey State Health Plan (approved December 17, 1982) the broad state planning mandate of the NHPRDA is noted, which mandate goes far beyond passing on certificate of need applications:

> "The National Health Planning and Resources Development Act of 1974...is of particular significance because it represents the first piece of federal legislation to address the crucial need for a national health policy.
>
> * * *
>
> On April 21, 1976 the Governor of New Jersey designated the New Jersey State Department of Health as the official State agency for purposes of implementing State responsibilities

under terms of Public Law 93-641 and its subsequent amendments (Public Law 96-79). These responsibilities include the administration of a State Administrative Program prescribed by Section 1522 of the Act and the execution of State health planning and development functions prescribed within Section 1523." Id. at 1.

Within the body of New Jersey's State Health Plan prepared in accordance with NHPRDA, under a section labeled "Priority Setting Process" it is stated:

> "The most effective cost containment system that does not sacrifice quality care is a prepaid capitation system of health care, or health maintenance organization (HMO). Enrolling a person in an organization which receives a fixed annual fee and agrees to provide whatever care is needed: (1) increases outpatient visits slightly; (2) cuts inpatient days nearly in half; (3) substantially reduces total costs (insurance premium and out-of-pocket); and (4) sacrifices no substantive quality in care....
>
> * * *
>
> Although HMOs are relatively effective in providing preventive services, they are most

> notably effective as a system of health care that achieves cost containment without detriment to health, and their development is, therefore, a priority in the Section on Cost Containment Issues." Id. at 253, 277-78.

Thus, the State Respondents' argument to the contrary notwithstanding, New Jersey acknowledges in its judicially noticeable State Plan that broad planning processes implicating HMO development and sustenance are mandated by NHPRDA. However, before implementing the DRG plan in 1980, the New Jersey Department of Health should have considered the "special needs and circumstances of health maintenance organizations" mandated by Congress to be incorporated in the planning process of State Health Agencies pursuant to 42 U.S.C. §300n-1(c)(8). That assessment should have reviewed the devastating impact on fundamental HMO operating incentives caused by the DRG system. Read in pari materia

with the preemption provisions of 42 U.S.C. §300e-10 this assessment would have mandated exemption of federally qualified HMOs from the New Jersey DRG system.

3d. Finally, it is disingenuous for the State Respondents to assert that "an avenue of relieving economic hardship was made specifically available by administrative appeal to the New Jersey Hospital Rate Setting Commission". N.J. Br. in Opp. 12n*. With no standard, no definitions, or no procedures outlining the dimension of this "relief" the procedure was a sham. (R. Vol. 2, 103; Pl. Ex. 9). Moreover, it is fundamental that a petitioner need not pursue state remedies when federal statutory rights are implicated.

Conclusion

In light of the inability of the state and federal respondents to face the issues in the petition without grossly distorting

the total corpus of pertinent federal HMO statutory law and the policies that inspired those laws, the need for plenary review of the action below is indisputable; indeed, petitioner suggests that reversal after full argument is now in order.

Respectfully submitted,

Robert F. Blomquist
Counsel for Petitioner